

# Audit Report



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**HOTLINE ALLEGATIONS INVOLVING  
CONTRACTS FOR PROGRAMMED DEPOT  
MAINTENANCE OF KC-135 AIRCRAFT**

Report No. 98-122

April 24, 1998

**Office of the Inspector General  
Department of Defense**

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INSPECTOR GENERAL  
DEPARTMENT OF DEFENSE  
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ARLINGTON, VIRGINIA 22202

April 24, 1998

MEMORANDUM FOR ASSISTANT SECRETARY OF THE AIR FORCE  
(FINANCIAL MANAGEMENT AND COMPTROLLER)  
DIRECTOR, DEFENSE LOGISTICS AGENCY  
DIRECTOR, DEFENSE CONTRACT AUDIT AGENCY

SUBJECT: Audit Report on the Hotline Allegations Involving Contracts for  
Programmed Depot Maintenance of KC-135 Aircraft (Report No. 98-122)

We are providing this audit report for information and use. We conducted the audit in response to allegations made to the Defense Hotline. Because this report contains no recommendations, no management comments are required.

We appreciate the courtesies extended to the audit staff. Questions on the audit should be directed to Mr. Richard B. Jolliffe, Deputy Director, Contract Management Directorate, at (703) 604-9202 (DSN 664-9202), Email <rjolliffe@dodig.osd.mil> or Ms. Bobbie Sau Wan, Audit Project Manager, at (703) 604-9259 (DSN 664-9259), Email <bwan@dodig.osd.mil>. See Appendix C for the report distribution. The audit team members are listed inside the back cover.

*David K. Steensma*

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Deputy Assistant Inspector General  
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**Office of the Inspector General, DoD**

**Report No. 98-122**  
(Project No. 7CA-8007.01)

**April 24, 1998**

**Hotline Allegations Involving Contracts for  
Programmed Depot Maintenance of KC-135 Aircraft**

**Executive Summary**

**Introduction.** We performed the audit in response to 15 allegations made to the Defense Hotline involving two contracts on the Programmed Depot Maintenance of the KC-135 Aircraft, which Oklahoma City Air Logistics Center awarded to Pemco Aeroplex, Incorporated. This report addresses 6 of 15 allegations. The remaining nine allegations are pending review.

**Audit Objectives.** The overall objective was to evaluate whether Oklahoma City Air Logistics Center followed appropriate acquisition regulations in contracting for programmed depot maintenance of KC-135 aircraft. We also evaluated the Oklahoma City Air Logistics Center management control program as it applied to the audit objectives.

**Audit Results.** The six allegations addressed in this report were unsubstantiated.

**Management Comments.** We provided a draft of this report on March 4, 1998. Because this report contains no findings or recommendations, written comments were not required, and none were received. Therefore, we are publishing this report in final form.

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## **Part I - Audit Results**

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## **Audit Background**

This audit was done in response to allegations made to the Defense Hotline regarding two contracts that Oklahoma City Air Logistics Center awarded to Pemco Aeroplex, Incorporated (Pemco) for programmed depot maintenance on the KC-135 Aircraft. This report addresses 6 of the 15 allegations; nine other allegations are pending investigation.

The Oklahoma City Air Logistics Center is one of five air logistics centers under the Air Force Materiel Command that provide life-cycle weapon system sustainment, maintenance, and repair. The Oklahoma City Air Logistics Center provides logistic support and depot maintenance for the KC-135 aircraft. The Contracting Directorate manages and executes Oklahoma City Air Logistics Center contracting assignments and programs. The KC-135 is an Air Force tanker aircraft used for in-flight refueling of combat and combat-support aircraft as well as the transfer of cargo and passengers. The KC-135 fleet of aircraft makes up about two-thirds of the DoD tanker inventory and consists of 552 aircraft that are projected to be serviceable through the year 2030.

Pemco's parent company, Precision Standard, Incorporated is a diversified aviation and aerospace company located in Denver, Colorado. Precision Standard, Incorporated has three operating groups including Pemco, their Government service group, located in Birmingham, Alabama. Pemco provides aircraft maintenance and modification services for government and military customers.

Oklahoma City Air Logistics Center awarded Pemco two consecutive contracts for programmed depot maintenance. The scope of the contracts covered all depot-level activity including programmed depot-level maintenance; unprogrammed depot maintenance; modifications to keep the aircraft in a current configuration; manufacture, repair, overhaul, and purchase of parts and components; overhaul, maintenance, or repair of Government furnished property; work directed for drop-in aircraft; and other work directed by the procuring contracting officer and administrative contracting officer.

**Contract F34601-90-C-0286.** In January 1990, Oklahoma City Air Logistics Center competitively awarded a firm fixed price contract to Pemco for one year and four option years for \$6.6 million to perform major upgrades, corrosion prevention, and other modifications on 13 aircraft. The contract lasted five years and is now physically complete with a total of \$281.3 million in funds obligated for work on 312 aircraft.



**Contract F34601-94-C-0664.** In August 1994, Oklahoma City Air Logistics Center awarded a firm fixed price contract under competitive procedures to Pemco for one year with six option years to run through FY 2001. As of June 1997, funds obligated on the current contract totaled \$153 million for 99 aircraft processed.

## **Audit Objectives**

The overall objective of the audit was to evaluate whether Oklahoma City Air Logistics Center followed regulations in contracting for programmed depot maintenance of KC-135 aircraft. The specific audit objective was to determine the validity of allegations made to the Defense Hotline and to evaluate the management control program as it applied to the audit objectives. See Appendix A for a detailed discussion of the audit process and Appendix B for a summary of prior coverage.

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## **Allegations Involving Pemco**

The Defense Hotline received correspondence alleging an assortment of irregularities and waste involving Oklahoma City Air Logistics Center and Pemco. Specifically, the six allegations addressed in this report alleged improprieties involving Pemco's pension plans, conflicts of interest, misappropriated assets, unnecessary labor expenses, and potential aircraft safety issues. Details of the allegations, all of which were unsubstantiated, follow.

**The Air Force failed to pursue recovery of a proportional share of the significant monetary benefits accrued by Pemco as a result of the company's decision to cease contributions to its employee pension plans.** The allegation was unsubstantiated. Prior to June 30, 1991, Pemco sponsored seven different pension plans. On that date, Pemco merged the existing plans into two pension plans. Based on the Internal Revenue Code, each of the two new plans was over funded because of the merger. Pemco made no contributions to these pension funds from June 30, 1991 through 1993. The allegation stated that Pemco benefited from the over funded position because the Government paid indirect rates that included pension expenses during the time when Pemco was not making contributions to the pension funds. The indirect rates paid under contract F34601-90-C-0286 were determined by a negotiated agreement between Pemco and the Defense Plant Representative Office. The agreement did not contain a contract clause that would allow the Government to renegotiate indirect rates. The pension fund merger was made in compliance with Cost Accounting Standards and the Federal Acquisition Regulation.

**Employment of retired military personnel by Pemco and by Precision Standard, Inc. (Pemco's parent company) in a management capacity represents a conflict of interest.** The allegation was unsubstantiated. The allegation stated that retired generals and admirals on the Precision Standard, Inc. board of directors, and a retired colonel performing as the general manager of Pemco, used past positions and associations to exercise undue influence over Government decisions. The current retired military personnel serving on the board of directors did not hold positions which would have been in the direct chain of command for either procurement or oversight of the KC-135 programmed depot maintenance. (The chain of command for Oklahoma City Air Logistics Center contracting and the KC-135 System Program Office is Air Force Materiel Command.) One of the board members retired as a Navy Admiral in 1982 and another was an Air Force General who served in the U.S. Air Forces European Command for three years prior to his retirement in 1989.

The current General Manager of Pemco retired from the Air Force in September 1996. As the former Chief of Aircraft Production Division, Oklahoma City Air Logistics Center, he was involved in managing the Air Force KC-135 Depot located at Tinker Air Force Base, Oklahoma. Based on the retirement date, his post employment restrictions fall under 18 U.S. Code 207 and the Procurement

**Integrity Act (41 U.S. Code 423).** His position did not violate post employment restrictions because he was not personally and substantially involved in the procurement or program oversight of the KC-135 maintenance contract with Pemco, nor was it part of his official responsibility.

**Fuel from the Pemco installation was misappropriated.** The allegation was unsubstantiated. This allegation stated that Pemco improperly removed fuel from KC-135 aircraft prior to the start of programmed depot maintenance. Defense Plant Representative Office personnel at Pemco believed that the fuel was contaminated and that the fuel was being hauled away and used by the University of Auburn for its waste oil recycling research program. The allegation contends that the fuel was not contaminated and that a private company was removing the fuel for undisclosed use. The Air Force Office of Special Investigations conducted an investigation into the circumstances surrounding the alleged missing fuel. The investigation was closed after the Assistant U.S. Attorney, Birmingham, Alabama, declined to prosecute because it could not be determined that the amount of missing fuel was significant enough to warrant further action.

**KC-135 insulation was unnecessarily replaced and Pemco personnel took the scrap insulation for personal use.** The allegation was unsubstantiated. Personnel at Defense Contract Management Command Pemco (formerly the Pemco Defense Plant Representative Office) referred this incident to the Defense Contract Management Command fraud counsel. The evidence presented was deemed insufficient to warrant further investigation. Controls were implemented to prevent any further scrap insulation removal for personal use.

**Air Force paid an unnecessary premium for production break drilling.** The allegation was not substantiated. The KC-135 wing is made in two pieces. The outboard wing is connected to the inboard wing by six cast aluminum components called production break fittings. The components referred to in this allegation are the two upper production break fittings. Pursuant to the contract, the Air Force was responsible for supplying the production break fittings as Government furnished material. In 1993, the Air Force stock of upper production break fittings was depleted and Pemco was granted authority to find a private-sector source and to procure the production break fittings from that source whenever Government parts were not available.

Pemco found a source for upper production break fittings and placed an order for five in July 1993, but that source had problems drilling the holes specified by drawings. Oklahoma City Air Logistics Center engineers approved the part for use but, to avoid further problems with pre-drilled holes, Pemco was instructed to purchase production break fittings without holes and to drill the holes on-site. The allegation stated that the Air Force was paying an unnecessary premium for Pemco to drill holes in the production break fittings because the production break fittings purchased by Oklahoma City Air Logistics

## Allegations Involving Pemco

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Center were manufactured according to engineering specifications (with pre-drilled holes) and did not require additional drilling.

Oklahoma City Air Logistics Center made a good business decision by authorizing Pemco to buy production break fittings from a second source. The production break fittings purchased by Pemco were less than the Air Force cost, even with the added cost of drilling the breaks on-site. Additionally, the lead time from Pemco's source was shorter than the lead time on Air Force production break contracts.

**The aircraft completed programmed depot maintenance without replacement of static port linings.** The allegation was substantiated, but deemed to be harmless. The static port lining is an insulation pad located in the forward belly section of the plane between the removable fuel cell and the aircraft frame. Small tubes run through this section from an exterior sensor to the cockpit. No one could determine the actual purpose of the lining, but it is assumed that it is to protect either the fuel cell or the sensor tubes. The linings were removed to apply a corrosion preventive compound inside the aircraft and were not replaced before Pemco completed maintenance on the aircraft.

This allegation was a potential flight safety issue and was referred to the Air Force Safety Office at Kirkland Air Force Base for determination. The Safety Office engineer reviewed the purpose of the linings and any possible safety implications. The engineer determined that the lack of a lining is not an imminent safety issue that would warrant the immediate replacement in the field. The Safety Office engineer, however, agreed with the Oklahoma City Air Logistics Center KC-135 program engineer that the lining should be replaced during the next programmed depot maintenance for each aircraft. The procuring contracting officer directed the contractor to install new linings when applying the compound and reinstall any missing linings during the next programmed depot maintenance.

## **Conclusion**

The six allegations addressed in this report were basically unsubstantiated. The substantiated element of the sixth allegation discussed did not represent infraction of any law, regulation, or safety requirement.

## **Part II - Additional Information**

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## **Appendix A. Audit Process**

### **Scope and Methodology**

**Audit Scope.** We reviewed Oklahoma City Air Logistics Center and Defense Contract Management Command management of contracts for programmed depot maintenance for KC-135 aircraft. Specifically, we reviewed contract actions involving Pemco under contracts F3410-C-90-0286 and F3410-C-94-0664, including the Pemco request for equitable adjustments and Oklahoma City Air Logistics Center contract modifications. In performing the audit, we interviewed Defense Contract Management Command and Oklahoma City Air Logistics Center personnel involved with contract management. We reviewed documentation dating from 1990 through 1997.

**Audit Period, Standards, and Locations.** We conducted this economy and efficiency audit from January 29, 1997 to May 30, 1997 in accordance with audit standards issued by the Comptroller General of the United States as implemented by Inspector General, DoD. We visited or contacted individuals and organizations within DoD. Further details are available upon request.

**Review of Documentation.** We reviewed documentation maintained by the Oklahoma City Air Logistics Center and Defense Contract Management Command to determine the validity of the Hotline allegations applicable to contracts F3410-C-90-0286 and F3410-C-94-0664. We reviewed:

- o Price negotiation memorandums
- o Original contracts and contract modifications
- o Defense Contract Audit Agency audit reports
- o Documents relating to requests for equitable adjustment
- o Internal memorandums and claim reports
- o 10K form
- o Partial DD 250 payments
- o Air Force Materiel Command policy and procedures
- o Oklahoma City Air Logistics Center Contracting policy and procedures

## **Management Control Program**

DoD Directive 5010.38, "Management Control Program," August 26, 1996, requires DoD organizations to implement a comprehensive system of management controls that provides reasonable assurance that programs are operating as intended and to evaluate the adequacy of the controls.

**Scope of Review of Management Control Program.** We reviewed the adequacy of the Oklahoma City Air Logistics Center management controls over its acquisition of programmed depot maintenance for KC-135 aircraft. Specifically we reviewed Oklahoma City Air Logistics Center management controls over compliance with applicable regulations in its acquisition of programmed depot maintenance.

**Adequacy of Management Controls.** Our assessment of the adequacy of Oklahoma City Air Logistics Center management controls is still under review and will be addressed in a separate report.

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## **Appendix B. Summary of Prior Coverage**

The General Accounting Office issued one report on the maintenance and cost of the KC-135 aircraft.

General Accounting Report No. GAO/NSIAD96-160, "Aging Refueling Aircraft are Costly to Maintain and Operate," August 8, 1996. The report states that the Services' air refueling tanker aircraft meet current needs, however, satisfying future requirements may be difficult. The long term serviceability of the KC-135 tanker fleet is questionable, because the aircraft are 30 to 40 years old and taking progressively more time and money to maintain. The Air Force could potentially spend over \$6 billion in modifications and structural repairs to keep the KC-135 fleet operational. Though the Air Mobility command believes that operating the KC-135 beyond 2020 is not economical, it does not plan to replace the tanker until approximately 2013. The DoD acknowledged that they have been successful in using a single aircraft, such as the KC-135 to accomplish both airlift and tanker missions. However, DoD would not commit to the procurement of a dual use aircraft until an analysis can be done on an aircraft fulfilling both the air lift and refueling mission and requirements. The report recommended that the Secretary of Defense require that future studies and analyses of replacement airlift and tanker aircraft encompass both mission areas, with the goal to identify the optimum size, mix and time to procure a multi-mission aircraft that, when combined with C-5B, C-17s, and KC-10, will meet those requirements. DoD agreed that future studies and analyses of aircraft should include an analysis of using one aircraft to accomplish airlift and refueling missions.



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Under Secretary of Defense (Comptroller)  
Deputy Chief Financial Officer  
Deputy Comptroller (Program/Budget)  
Assistant Secretary of Defense (Public Affairs)

### **Department of the Army**

Assistant Secretary of the Army (Financial Management and Comptroller)  
Auditor General, Department of the Army

### **Department of the Navy**

Assistant Secretary of the Navy (Financial Management and Comptroller)  
Auditor General, Department of the Navy

### **Department of the Air Force**

Assistant Secretary of the Air Force (Financial Management and Comptroller)  
Assistant Secretary of the Air Force (Acquisition)  
Commander, Air Force Materiel Command, Dayton, OH  
Commander, Oklahoma City Air Logistics Center  
Auditor General, Department of the Air Force

### **Other Defense Organizations**

Director, Defense Contract Audit Agency  
Director, Defense Logistics Agency  
Commander, Defense Contract Management Command, Boston MA  
Commander, Defense Contract Management Command, Pemco Aeroplex, Inc.,  
Birmingham, AL

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Senate Committee on Armed Services  
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House Committee on Appropriations  
House Subcommittee on National Security, Committee on Appropriations  
House Committee on Government Reform and Oversight  
House Subcommittee on Government Management, Information, and Technology,  
Committee on Government Reform and Oversight  
House Subcommittee on National Security, International Affairs, and Criminal  
Justice, Committee on Government Reform and Oversight  
House Committee on National Security

## **Audit Team Members**

**This report was prepared by the Contract Management Directorate, Office of the Assistant Inspector General for Auditing, DoD.**

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